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Battle Brewing Over FY 1992 Budget

The process of compiling the FY 1992 general account budget promises to be more heated than usual as Tokyo tries to juggle conflicting policy goals. In line with guidelines adopted in July by the cabinet of Prime Minister Toshiki Kaifu, total discretionary spending requests are up 5.2 percent, the largest increase since FY 1982 (see JEI Report No. 26B, July 12, 1991). According to some observers, this increase signals the de facto end of the Ministry of Finance's austere fiscal policy. MOF officials counter this interpretation; they say the ministry will slash certain categories to cut total spending and tinker with some politically sensitive budget mechanisms out of concern for the government's steadily growing debt-service costs.

Following the August 31 deadline for FY 1992 budget requests, MOF reported that initial general account requests totaled Y76.2 trillion ($564.3 billion at Y135=$1.00), an 8.3 percent gain over FY 1991's initial total (see Table 1). This figure is composed of requests for Y39 trillion ($288.6 billion) in discretionary spending, Y1.3 trillion ($9.6 billion) for public works funded by the sale of government-held shares of Nippon Telegraph and Telephone Corp., and Y35.9 trillion ($266.2 billion) in nondiscretionary spending.

Table 1: Summary of FY 1992 General Account Budget Requests

(in billions of yen and percent change*)

	Request	Change
Discretionary Spending	Y38,956.0	5.2%
Industrial Investment Special Account	1,300.0	0.0
Nondiscretionary Spending	35,922.0	12.2
Debt Service	17,546.3	9.4
Transfers to Local Governments	18,375.7	15.0
Total	76,178.0	8.3

*Change from initial FY 1991 budget.

Source: Ministry of Finance

A breakdown of discretionary spending requests by government organization shows that almost every agency expects to win solid budget increases for the year beginning April 1, 1992 (see Table 2). The Japan Defense Agency request for just a 5.4 percent increase to Y4.6 trillion ($34.2 billion) reflects the perception of a lower regional security threat now that the Soviet Union is in a state of internal flux. JDA plans to cut hardware purchases by 4.8 percent to just over Y1 trillion ($7.5 billion) while boosting money for personnel and related costs 11.7 percent to nearly Y1.8 trillion ($13 billion). Foreign aid spending could rise as much as 9.8 percent as Tokyo tries to fulfill a pledge to disburse $50 billion in official development assistance between 1988 and 1992; the rapidly changing situation in the Soviet Union could lead to an even further gain in the ODA budget. Requests for environmental programs rose 5.3 percent to Y506.4 billion ($3.8 billion), an indication of Tokyo's efforts to play a larger role in handling global environmental issues.

The pending FY 1992 general account budget underscores the government's commitment to improve the quality of life. In addition to a Y1.3 trillion ($9.6 billion) transfer to the Industrial Investment Special Account from NTT stock sales, a line item since FY 1988, and a special Y200 billion ($1.5 billion) allocation for infrastructure improvements first authorized in the current fiscal year's budget, MOF plans another Y200 billion ($1.5 billion) special account for public works. The Finance Ministry also has penciled in a 14 percent hike for the Fiscal Investment and Loan Program, a capital budget funded by nontax revenues. Proposed FILP outlays of nearly Y33.2 trillion ($245.7 billion) not only will support housing and road construction but also major foreign aid programs through such agencies as the Export-Import Bank of Japan.

The proposed additions are somewhat misleading. Since total requests by all government agencies were nearly double the Y200 billion ($1.5 billion) per account limit penned by MOF, tough interministerial negotiations lie ahead. The Y1.3 trillion ($9.6 billion) transfer to the Industrial Investment Special Account also is interesting because it is funded by the sale of government-held shares of NTT stock. MOF has announced that it hopes to auction another 500,000 NTT shares before the end of this year, but poor stock market conditions have

Table 2: FY 1992 General Account Budget Requests by Agency

(in billions of yen and percent change*)

Agency	Request	Change
Imperial Household	Y7.6	27.7%
Diet	102.9	5.4
Judiciary	273.4	2.2
Board of Audit	13.8	8.7
Cabinet	14.1	2.1
Prime Minister's Office	8,376.2	3.4
of which: Defense Agency	4,622.0	5.4
Ministry of Justice	502.4	4.5
Ministry of Foreign Affairs	630.7	9.4
Ministry of Finance	1,542.0	9.6
Ministry of Education	5,296.7	4.8
Ministry of Health and Welfare	12,882.2	5.7
Ministry of Agriculture, Forestry and Fisheries	2,668.7	1.4
Ministry of International Trade and Industry	857.2	9.0
Ministry of Transportation	844.4	2.0
Ministry of Posts and Telecommunications	31.0	6.0
Ministry of Labor	488.1	0.2
Ministry of Construction	4,109.6	2.6
Ministry of Home Affairs	115.0	70.3
Infrastructure Investment	200.0	0.0
Total Discretionary Spending	38,956.0	5.2

*Change from initial FY 1991 budget.

Source: Ministry of Finance

clouded the auction's outlook. Although the last such sale was held in 1988, the government has spent only Y5.2 trillion ($38.5 billion) of the approximately Y10 trillion ($74.1 billion) netted from three previous stock sales. Even if the sale is put off again this year, MOF can continue doling out earlier proceeds in increments of Y1.3 trillion ($9.6 billion) for several more years.

MOF will stick with its hard-line position against big discretionary spending increases in the coming fiscal year for two reasons. First, the total amount of outstanding public bonds will continue to grow, surpassing an estimated Y168 trillion ($1.2 trillion) in FY 1992 or over one-third of nominal gross national product. The cost of servicing this debt will outpace again overall budget growth; debt service will eat up 23 percent of FY 1992's projected general account outlays. Last year's growth was almost 11 percent. This inexorable expansion will continue to lead MOF to try to hold the line on discretionary spending in a bid to limit overall spending.

Second, MOF projects that tax revenues will grow only modestly in FY 1992. The revenue situation for the current fiscal year already is throttling

spending. The initial forecast for FY 1991 projected tax and stamp revenues of Y63 trillion ($466.7 billion), but the adopted budget shows revenues of only Y61.8 trillion ($457.8 billion). MOF budget planners expect a similar drop-off in FY 1992 as the economy slows. If recent stock and banking scandals (see JEI Report No. 33B, August 30, 1991) cast a larger-than-expected shadow over the economy, MOF may face even tougher spending constraints.

The revenue squeeze has prompted the Finance Ministry to raise a politically explosive idea: adjusting the formula for sharing certain central government tax revenues with local governments. Under the current formula prefectural and municipal administrations receive 32 percent of personal and corporate income taxes, 32 percent of liquor taxes, 24 percent of consumption tax revenues and 25 percent of tobacco taxes. MOF has suggested that local government revenues now are so healthy that the central government's revenue-sharing burden should be reduced. Jockeying over this proposal will add a completely new dimension to the FY 1992 budget process, perhaps impeding its progress.

The budget process still is in the early stages, however. From now until December MOF will hammer out detailed budgets in individual talks with each agency, leaving plenty of time for adjustments and changes.

Jon Choy

BOJ Watchers Anticipate Monetary Policy Shift

As attention in Tokyo turns to what the Bank of Japan might do about a perceived slowdown in the Japanese economy, at least one activity -- BOJ-watching -- has remained a growth industry. The overriding question is: what will Japan's central bank do about the faltering economy and when will it do it? The official answer -- that it will do nothing because nothing needs fixing -- resonates neatly with findings announced in late August by the Economic Planning Agency. EPA officially noted then that Japan's economy had tied the postwar record of 57 months of uninterrupted expansion. The official answer, however, has failed to quiet those who see in government data signs of a slowdown.

Some of the gloomy data comes from the Bank of Japan itself. The September 6 release of BOJ's diffusion index in its quarterly tankan (short-term survey of firms) showed a drop of 9 points from May to register 27 -- the lowest value since February 1988 -- on a scale that ranges from +100 to -100. (The diffusion index is calculated by subtracting negative responses from positive ones.) The tankan still contained some positive information for those hoping for a continuation of Japan's economic expansion. Large firms told BOJ that they plan to increase plant and equipment spending 7.9 percent in the fiscal year that began April 1, while small- and medium-sized companies reported plans to spend 0.4 percent less over the same period than they had in FY 1990. Both results represented upward revisions from the May survey. If these projections pan out, plant and equipment spending, which represented 22 percent of Japanese gross national product in the October 1990-March 1991 period, could provide strong support for an ongoing expansion.

Of course, companies responding to the BOJ survey base their forecasts in part on assumptions concerning central bank policies. One such assumption

Control Law. Under this law Japanese firms intending to export various dual-use items to certain countries must obtain an export license from the Ministry of International Trade and Industry. JAE's alleged involvement in the export of parts for use in missiles without such a license led Japanese police to arrest four JAE managers August 28. The police also reportedly plan to submit to prosecuters an investigative report on four other company officials believed to have had a part in the alleged weapons exports. The accusations leveled in the JAE case are the first against a major Japanese manufacturer under Japan's export control regulations since they were strengthened in the wake of disclosures that a Toshiba Corp. subsidiary illegally had sold sophisticated milling machines to the Soviet Union in the early 1980s. Steps were taken in 1987 both to bolster the legal framework and to strengthen enforcement. The JAE incident has served as a test case for the government's implementation of the revised regulations, Ministry of Foreign Affairs sources note.

The accusations against JAE come at an awkward time for the Japanese government. Prime Minister Toshiki Kaifu recently has indicated that Japan is prepared to take on a larger global political role by advancing arms control. Observers in both Tokyo and Washington are likely to be watching closely to see how the cases against JAE and Aero Systems unfold.

Margo Grimm

U.S. Builders Lobbying For Continued Machine Tool Quotas

The restraints put in place at the start of 1987 on U.S.-bound exports of Japanese-made machining centers, numerically controlled lathes, NC punching and shearing machines and three lower technology product lines are not scheduled to be lifted until the end of this year, but the campaign for extension of the limits has been in high gear for months. Legislators influential on trade and defense industrial base issues and the congressional delegations of major machine tool producing states have joined the domestic industry's trade association in lobbying the Bush administration to extend the voluntary restraint agreement with Japan as well as a similar VRA with Taiwan beyond December 31. Although the wording differs, Capitol Hill and NMTBA - The Association for Manufacturing Technology are delivering the same message to the White House. American machine tool builders have used the restraint period to improve their competitiveness but still are struggling to adjust to a shrunken customer base and aggressive foreign rivals. Without continued help on the trade front, VRA extension proponents add, the domestic industry will not be positioned to meet U.S. defense requirements.

Tokyo worked out an arrangement with Washington in November 1986 to limit exports of six types of machine tools to the United States for five years. It went that route rather than risk a threatened formal finding under Section 232 of the 1962 Trade Expansion Act that imports of machine tools from Japan undermined the viability of an industry essential to this country's national security and an accompanying presidential decision to roll back shipments by bigger margins than the negotiated cutbacks. Under the pact the government agreed to restrict exports of machining centers, NC lathes and NC punching and shearing machines to the U.S. market share levels Japanese suppliers controlled in 1981 -- the last big profit year for the boom-and-bust domestic machine tool industry (see Table 1). That meant a 21-percentage-point reduction in Japan's

Table 1: Estimated U.S. Machine Tool Orders, Shipments and Backlog, 1970-91

(in millions of dollars)

Year	Net New Orders	Shipments	Yearend Backlog
1970	$912	$1,443	$706
1971	861	998	569
1972	1,412	1,019	963
1973	2,613	1,501	2,074
1974	2,583	2,031	2,625
1975	1,277	2,452	1,450
1976	2,203	2,060	1,594
1977	2,995	2,281	2,308
1978	4,349	3,013	3,643
1979	5,621	3,877	5,388
1980	4,754	4,692	5,451
1981	2,945	5,096	3,300
1982	1,498	3,604	1,194
1983	1,696	1,845	1,045
1984	2,916	2,286	1,675
1985	2,528	2,545	1,658
1986	2,125	2,579	1,204
1987	2,119	2,324	1,000
1988	3,591	2,399	2,191
1989	2,808	3,196	1,804
1990	2,965	3,300	1,468
Seven Months 1990	1,657	1,898	1,563
Seven Months 1991	1,358	1,527	1,300

Source: NMTBA - The Association for Manufacturing Technology, Industry Estimate of Machine Tool New Orders, Cancellations, Shipments and Backlog.

1985 market share to 52 percent for machining centers, a rollback from 66 percent to 57 percent for NC lathes and a 24-point cut to 19 percent in the 1985 Japanese market share figure for NC punching and shearing machines. Tokyo also said it would use administrative guidance to make sure Japanese exporters did not exceed their 1985 U.S. market shares in milling machines (3 percent), manual lathes (5 percent) and manual punching and shearing machines (9 percent).

Mainly because of the difficulty of accurately forecasting demand over the short run in the cyclical machine tool business, the quotas on machining centers, NC lathes and NC punching and shearing machines generally have not sliced the U.S. market shares of Japanese exporters to the levels anticipated in the VRA (see Table 2). At a minimum, the agreement has prevented Japan-based suppliers from making additional inroads in the American market for these high technology products. In fact, the restraints have enabled U.S.-owned machine tool builders to regain some of the business lost to their Japanese counterparts in the late 1970s and the first half of the 1980s. Equally important, the industry's trade association says, companies making products covered by the VRA have used the breathing room created by the restraint arrangement to strengthen their product and process competitiveness.

Table 2: Japan's Exports of VRA-Covered Machine Tools to the United States, 1981-90

(in units)

	1981	1982	1983	1984	1985	1986
Machining Centers	2,180	1,728	1,957	2,858	3,602	3,435
Numerically Controlled Lathes	3,878	2,350	1,781	3,201	3,834	4,456
Other Lathes	642	449	200	254	331	123
Numerically Controlled Milling Machines	364	184	180	240	254	106
Other Milling Machines	495	1,693	1,570	2,416	2,168	2,317
Shearing and Punching Machines	1,462	1,040	2,369	2,855	2,559	4,824

	1987	1988	1989	1990
Machining Centers	2,064	1,523	2,350	1,780
Numerically Controlled Lathes	3,177	3,590	3,745	2,315
Other Lathes	111	118	270	135
Numerically Controlled Milling Machines	108	65	62	45
Other Milling Machines	1,584	1,110	413	122
Shearing and Punching Machines	5,535	3,730	4,076	5,499
of which: Numerically Controlled	n.a.	164	145	137

Note: In 1988 Japan switched its trade classification system. Therefore, the product categories for the 1988-90 period do not always match exactly those for earlier years.

Source: Japan Tariff Association, Japan's Exports & Imports.

In a position paper circulated at both ends of Pennsylvania Avenue in early July NMTBA pointed to the high productivity gains scored by the U.S. machine tool industry between 1987 and 1989 as proof that domestic manufacturers have made effective use of the restraint arrangements with Japan and Taiwan. The trade group also detailed how VRA-affected builders had increased spending for new equipment and research and engineering both absolutely and in relation to sales over the 1986-90 period. It warned, however, that these companies will not be able to reap the benefits of their investments or continue to spend larger amounts for equipment and research -- the keys to a stronger U.S. industry -- if the VRAs are allowed to lapse. Pretax profit margins, NMTBA noted, remain razor-thin despite the limits on Japanese and Taiwanese competition.

The American machine tool industry trade group has had little trouble mobilizing significant congressional support for an extended restraint program, which NMTBA has suggested should run for another three years with an option to renew for two more years. Pressure from Capitol Hill was decisive in getting the White House to respond in 1986 to NMTBA's long-running campaign for import relief. The trade association hopes the same strategy will work a second time. So far, however, the Bush administration officials who will decide whether or not Washington should seek new VRAs with Tokyo and Taipei have

not indicated which way they might be leaning. They also have given few hints on whether the extension request will be treated as a national security issue or as strictly a trade matter. Some Washington observers have argued that the machine tool industry might stand a better chance of winning White House support for continued restraints if it can persuade economic policymakers to consider the request for extended VRAs within the national security framework. To date only Department of Commerce officials have backed this approach.

Although Taiwanese officials already are lobbying the White House to let the restraint program expire, the Japanese government has taken no position on the renewal question. Second-guessing some of the concerns in Tokyo is not hard, though. Officials in the Ministries of Foreign Affairs and International Trade and Industry no doubt worry that a VRA extension, no matter what its length, could institutionalize limits on U.S.-bound exports of major machine tool products; all they have to do is look at what has happened under similar circumstances with Japanese shipments of cars and steel to this country. At the same time Japanese policymakers probably worry that shipments might surge if the restraints are ended; that outcome could add pressure to the tense U.S.-Japan trade relationship.

Government officials have received little public guidance from Japan's machine tool industry. Builders that have invested substantial amounts of money in U.S. production facilities -- like Yamazaki Mazak Corp., Hitachi Seiki Co., Ltd., Makino Milling Machine Co., Ltd., Okuma Machinery Works, Ltd. and Toyoda Machine Works, Ltd. -- are said to support an extended VRA, although there is some concern that machine tool exporters in other countries will continue to capitalize on the limits on made-in-Japan shipments. Japanese suppliers that have no onshore production base or that do only some assembly here show some signs of ambivalence but probably would be happy if the export ceilings were lifted.

Susan MacKnight

Notes

Baltic States - The Japanese government September 6 granted formal recognition to the Republics of Estonia, Latvia and Lithuania. Tokyo's decision to extend diplomatic recognition to the Baltic states was made in an evening cabinet meeting and announced soon after the Japanese government received official confirmation that Moscow had recognized the independence of the three republics. Foreign Minister Taro Nakayama said Tokyo would initiate discussions to establish actual diplomatic relations with the Baltics as soon as possible. He added that economic assistance for the republics would be considered after a government mission sent to the region September 1-10 returned to Tokyo. Although some Japanese press reports indicated that Tokyo would join other industrialized nations in extending some type of emergency aid to the Baltic states, foreign aid remains a big question, according to some Ministry of Foreign Affairs representatives.

Following the aborted coup attempt in the Soviet Union and declarations of independence by the three Baltic states, the Japanese government expressed in late August "support for the peaceful realization of independence by these

NOTE

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Entire Issue